Description of risks related to financial instruments

The aim of this description of risks is to provide Clients with information on the characteristics of financial instruments and the risks related to them as well as to caution about the possible losses that may occur during the provision of investment services. Clients need to know that they assume all of the possible risks related to investing.

"CBL Asset Management" IPAS hereby informs that the list of risks given below is not exhaustive and includes only the main risks. Clients may encounter other risks during the course of investing.

I General Risks

Government or political risk	the risk of losses which occur if events which negatively influence the political and/or economic situation take place in the country or region where the corresponding financial instruments and/ or the corresponding issuer of the financial instruments is registered and directly influencing the operations of the issuer and/ or safety of financial instruments' custody, incl. currency devaluation, adverse changes in legislation, creation of additional restrictions or barriers, nationalization processes, mass unrest and other factors.
Market risk	the total risk which includes price risk, foreign exchange rates risk, floating interest rate risk and liquidity risk.
Price risk	the risk of occurrence of losses as a result of financial instrument price volatility.
Foreign exchange rate risk	the risk of occurrence of losses as a result of exchange rate volatility.
Interest rate risk	the risk of occurrence of losses as a result of changes in floating interest rates.
Liquidity risk	the risk of occurrence of losses as a result of a limited ability or failure to sell financial instruments' positions that have been opened earlier at the desired time without a considerable reduction in the financial instruments' price.
Systemic risk	the risk of occurrence of losses as a result of inability to execute orders, settle payments or money transfers caused by dysfunctions in settlement centres or systems thereof.
Legal risk	risk of occurrence of losses and additional expenses due to amendments to laws and regulations.
Information risk	risk of occurrence of losses due to non-availability of truthful and comprehensive information on exchange rates, prices of financial instruments, market trends, and other information, which may directly or indirectly influence the value of financial instruments.

II Risks Related to Separate Types of Transactions

Transactions in foreign financial markets are subject to risks which may differ from the risks characteristic of similar transactions in Latvia. In separate cases these risks may even be much higher.

Investments in derivatives bear a high level of risk and they may not be suitable for certain groups of investors. Trading in derivatives usually takes place by applying financial leverage as a result of which large losses or yields may occur in comparison with transactions, which do not imply the use of financial leverage. This means that changes in market prices of financial instruments may entail proportionally much greater changes in the value of invested assets. Great price volatility is characteristic of some derivatives; this correspondingly increases the risk of suffering even bigger losses.

Transactions in non-regulated markets (over-the-counter) involve a relatively higher risk in comparison with the transactions closed on regulated markets because trading in financial instruments in non-regulated markets may be terminated, and the assessment and closing of open positions may be impeded.

III Risks Related to Separate Types of Financial Instruments

Basic Financial Instruments

Equities

Equities are securities issued by joint stock companies which serve as certification for the owner thereof that he/she owns a part of the property or capital of a particular enterprise and that he/she is entitled to dividends and/ or other types of income from ownership.

Risks:

1) Investor may purchase equities with the aim of selling them later in order to make a profit. However there is no guarantee of gaining profit because equities price depends on various factors, such as issuer's successful operation, industry, situation in the country of operation and international markets, etc. In particular cases partial or complete loss of invested funds is possible as, for example, in the case of the issuer's insolvency;
2) Investments in equities bear the risk of dividend cuts or suspension as the stock ownership does not guarantee the receiving of dividend payments since the enterprise management may resolve to refrain from paying dividends;
3) Liquidity factor is of great importance because even the equities listed on stock exchange may in particular cases be non-liquid.

Debt securities

Debt securities (bonds) certify the issuer's debt liabilities towards the bond holders.

The issue prospectus states the date for the repayment (maturity) of debt securities, interest rate (coupon), interest (coupon) payment frequency and other important parameters. One and the same enterprise may have debt securities which differ by the sequence of satisfying creditors' claims in the event of insolvency of the enterprise (senior debt, subordinated debt).

Debt securities may be issued by states, municipalities, international organizations, credit institutions, and commercial enterprises. The potential yield level of debt securities depends on the issuer's credit rating – the lower the credit rating, the higher the probability of the issuer's insolvency, and, consequently, the higher the expected yield. Lower credit rating also means greater risk of losing one's investment partially or fully. One and the same enterprise may have several types of debt securities (senior debt, subordinated debt, asset backed) with different credit ratings.

Investor, upon the purchase of debt securities, plans to earn by receiving interest (coupon) payments and/or from the price increase of the securities in the secondary market.

Risks:

1) A chance exists that the issuer might not be able to repay the investor the principal sum and/or coupons (credit risk) in the event he/she goes bankrupt;
2) If market interest rates increase, the price of debt securities with smaller coupons and longer maturity are subject to greater changes than that of the debt securities with larger coupons and shorter maturity. Investors may lose part of their investments if debt securities are sold before maturity (repayment) date.

   Another significant factor is the liquidity risk, especially for investors trading debt securities over-the-counter.
3) There are also structured debt securities. The price of structured debt securities in the secondary market depends on changes in the price of the underlying assets. A risk of losing the invested principal sum and income may exist. A description of potential risks is available in the structured financial products section.

Judging by risk level, "CBL Asset Management" IPAS categorizes debt securities into two groups: investment grade and non-investment grade. Investments in debt securities rated as investment grade by one of the leading rating agencies *(Moody's, S&P, Fitch)* are considered less risky in comparison with non-investment grade debt securities.

Investment funds

Investment funds are pools of assets collected from many investors for the purpose of investing in certain segments of the financial market, i.e. equity, bonds, real estate, etc., within the scope of a single strategy. Such pooling of assets enables optimizing costs, minimizes risks by means of spreading assets across several types of securities, as well as grants access to otherwise inaccessible markets and enables hiring professional asset managers whose tasks are to maximize the returns on assets. In other words, purchasing an investment fund share means acquiring a diversified and professionally managed portfolio of securities into one's possession.

Investment funds may be open-ended (fund shares can be sold at any time) and closed-ended (investors can receive money only upon liquidation of a fund at the pre-defined moment). Funds can also be divided into UCITS / Non-UCITS types of funds, depending on whether or not the operations of the funds in question are compliant with the EU UCITS IV Directive.

Risks:

Investments in funds involve different levels of exposure to risk depending on the financial instruments or segments of the financial market, in which the investments are made. Cash and bond funds are widely thought to be less risky as they are characterised by smaller fluctuations in the value of fund shares. Investments in balanced funds and equity funds are reciprocally considered to bear larger risks due to larger fluctuations in the value of such funds' shares, which, however, enables to generate higher yields in favourable market development conditions. The purpose, category, investment restrictions, risk level, costs, and other essential information are described in fund prospectuses.

In terms of risk level, investments in such open-ended UCITS as money market, bond and balanced funds are associated with smaller risks. The next group of funds in terms of risk level is the open-ended UCITS equity funds and other open-ended UCITS funds. Whereas the investments in open-ended non-UCITS funds, closed-ended investment funds, and funds involved in alternative investments are associated with the highest level of risk.

Prior to making an investment decision Clients must thoroughly acquaint themselves with the key investor information document, the investment fund's prospectuses, historical performance indicators and annual statements. As a rule, this information is published on the websites of the funds managing companies and/or websites of their distributors in order to provide a potential investor with the possibility to understand the investment strategy exercised by particular funds and the risks associated with investments in such financial instruments.

Derived Financial Instruments

Derivatives are bipartite contracts to buy or sell assets the value of which depends on the price of other assets (equities, bonds, foreign exchange rates, floating interest rates, indexes, commodities, etc.). Derivatives are traded either on a stock exchange (*exchange traded derivatives*) or in the over-the-counter market (*over-the-counter (OTC) derivatives*). Since the risks associated with such financial instruments can vary greatly depending on the base asset of the transaction, one must also assess risk profiles of each derivative instrument separately.

In addition to the complex structure of the product, there are also risks associated with the fact that leverage mechanisms apply to many derivatives. This means that only a part of the total value of the purchased financial instrument is covered by the investor with his/ her own resources (in the shape of a premium or initial margin), while the remaining part is actually borrowed. Therefore leverage can increase both the potential return on an investment and the potential losses.

Future Transactions (Futures, Forward contracts, Options)

Futures are bipartite contracts to buy or sell a financial instrument (index, equity, debt securities, foreign exchange rates, floating interest rates, commodities) at a specified future date for a price agreed upon at the moment of transaction. As a rule, future contracts set forth an obligation for both parties to perform the particular transaction (with the exception of an investor purchasing an option, who obtains the right).

Futures contracts can be either traded at stock markets (*futures*) or over-the-counter (*forwards*).

The futures traded at stock markets are standardized transactions with a fixed transaction value, delivery date, and other parameters, whereas the parameters of forwards can be adapted to the needs of investors. Whether in case of a stock-exchange transaction, or an over-the-counter future transaction, the investor has to pay in a security deposit. Security deposits (margins) for futures are required by clearing houses whereas margins for forwards are required by credit institutions or intermediaries.

Risks:
The risks associated with futures contracts are price volatility, liquidity and floating interest rate risks. Over-the-counter forward transactions are also associated with counter-party risk.

Options are derivatives which give the buyer the right to buy or sell certain assets (equities, bonds, foreign exchange rates, floating interest rates, indexes, commodities, etc.) at a specified price in the future (within a specified term or before it). The buyer of an option obtains the right to execute a transaction whereas the seller is obliged to perform the transaction if the buyer wishes so. The buyer of the option pays the seller a certain sum (premium) for the right to execute the transaction.

Options are traded both at the exchange and over-the-counter. Exchange-traded options are standardized transactions with a fixed transaction value, delivery date, and other parameters whereas the parameters of over-the-counter options can be adapted to the needs of investors. Margins (security deposits) are required to be paid in by investors in case of selling options. Margins for exchange-traded options are required by clearing houses whereas credit institutions or intermediaries may require margins for over-the-counter options.

Risks:

1) Risks are limited for the buyer because the premium paid upon the execution of the contract is the only inevitable costs the buyer encounters. In turn, the risk of the seller is unlimited.
2) Other risks associated with options are price volatility, liquidity and floating interest rate risks. Options lose their value if they are not used before the due date thereof. Options traded over-the-counter also face counter-party risk.

Swap Transactions

Swaps are bipartite contracts in which parties agree to exchange assets for a predetermined period at a price agreed upon at the moment of transaction. Cash flows can depend on floating interest rates, foreign exchange rates, equity prices or commodity prices, etc. The two main types of swap transactions are foreign exchange swaps and interest rate swaps.

Currency swaps are represented by one of the following foreign currency transactions: exchange of a certain amount in one currency for another currency on a value date at a current exchange rate (the rate is determined upon the execution of the transaction), and the reverse exchange of the same amount and the same currency on a determined date in future at an exchange rate determined upon the execution of the transaction. The currency exchange rate usually depends on the difference between the interest rates of the two currencies involved.

Interest rate swaps (IRS) are instruments in which counter-parties agree to exchange interest rate cash flows, i.e. commitment to perform interest payments within the determined deadlines (frequency); interest rates are calculated using the determined principal sum plus interest.

Risks:

The main risk associated with foreign exchange swaps is the interest rate risk. Besides of that, other risks include the foreign exchange risk, which applies only to the difference in the interest to be paid, as well as the liquidity and the counter-party risk. In the event of unfavourable price changes for the financial instruments, the counter-party may request additional margins.

The main risks associated with interest rate swaps are the interest rate and counter-party risks.